Economic & Revenue Outlook

Presented to
BaseCamp SRI

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Seattle, Washington

Summary

- There is evidence that the economic recovery stumbled in May – <u>we are now predicting near-term weakness, but a continuing recovery</u>
- The downside risk to the forecast have increased, however
  - Weak employment reports in May and June
  - Weak retail sales report in May and June
  - Fears of European contagion
- Other risks are the same as before
  - Downside: weak construction; community banks; tight credit for small business
  - Upside: exports; aerospace; software

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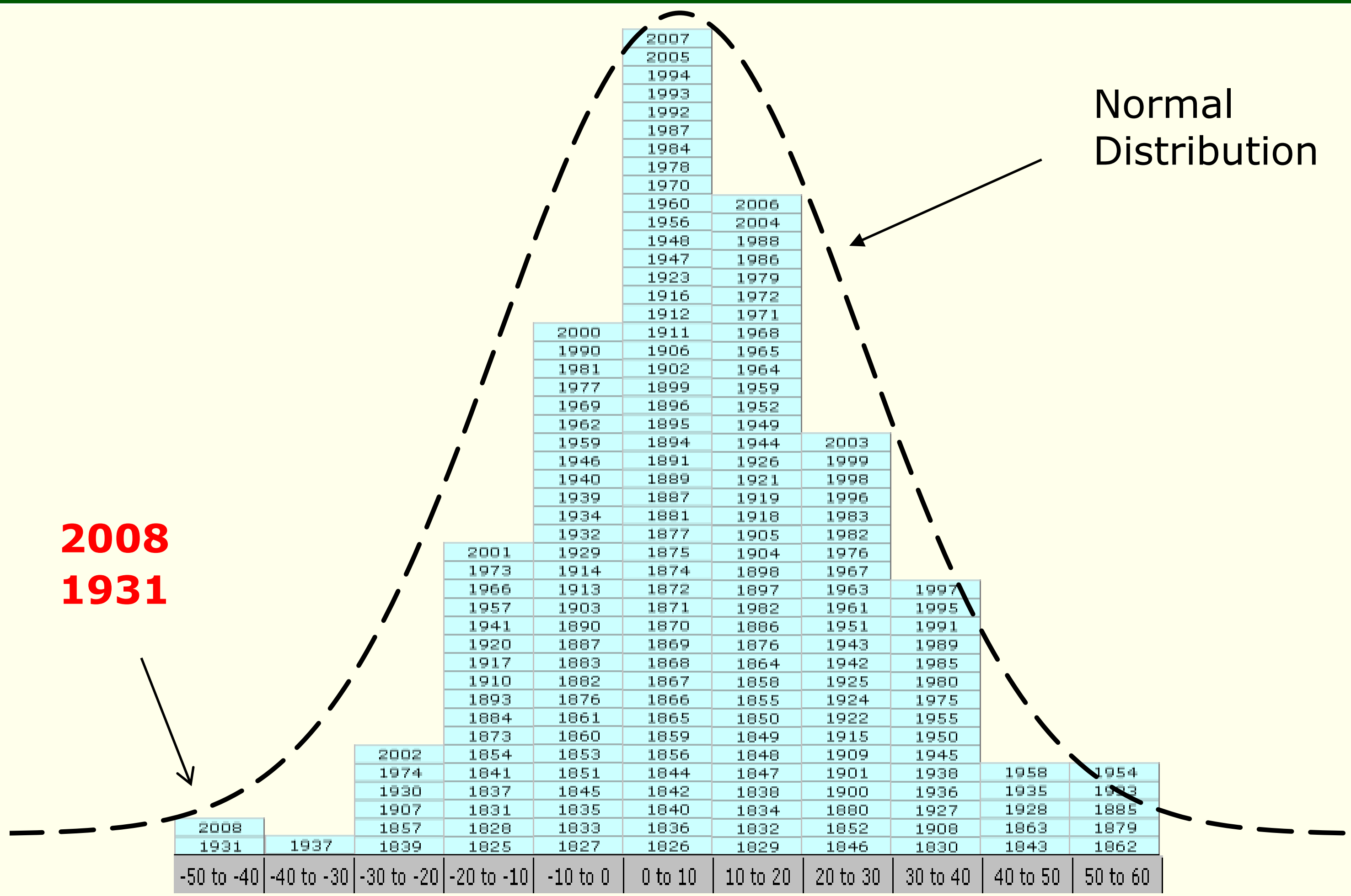
Equity returns in 2008 were a tail event

U.S. Stock Market Total Returns

1825 - 2008



Source: AXA

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At this stage in 1981-82, the state economy had made up all of the job losses

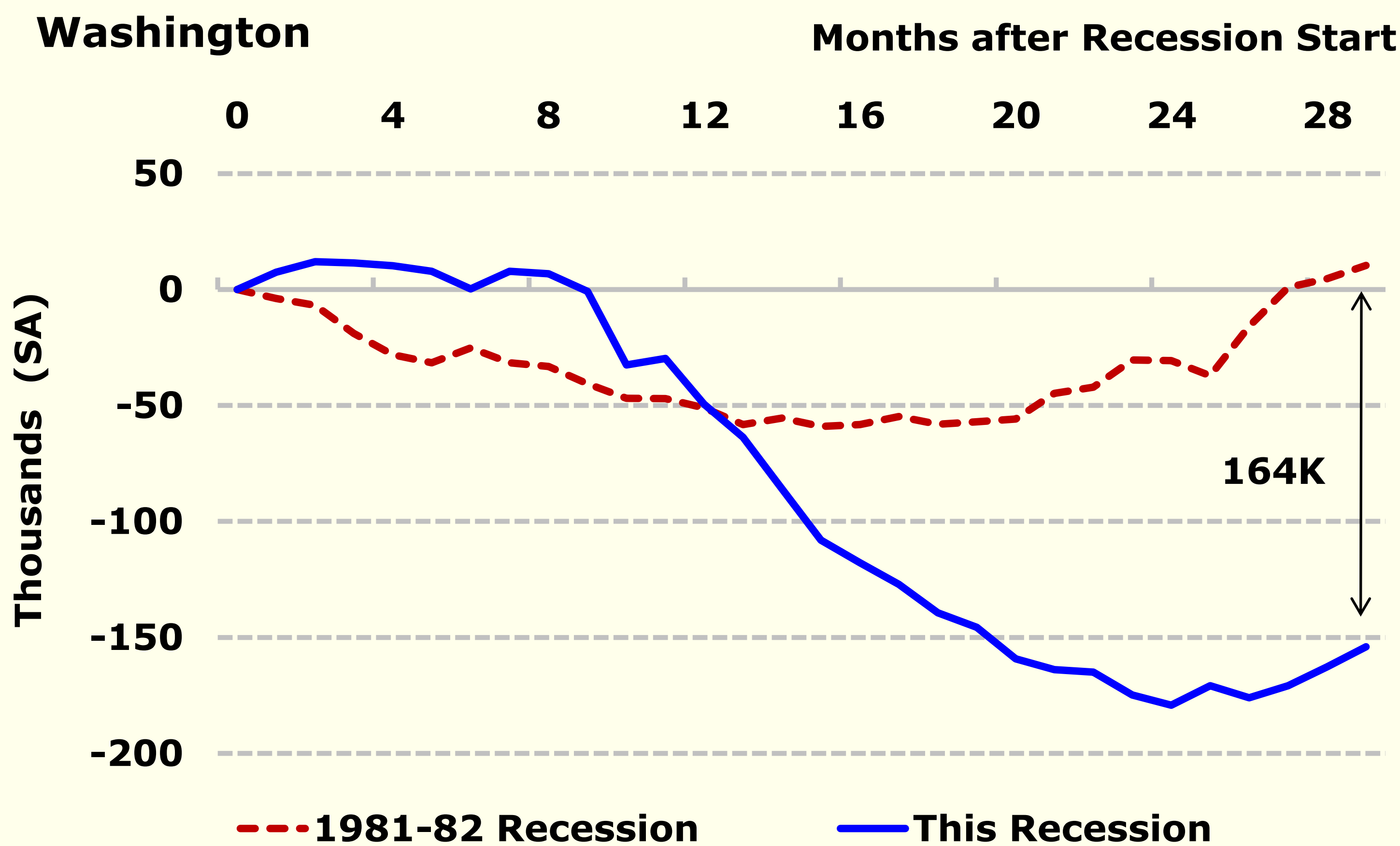
<u>Peak to trough job losses</u>

1981-82:

2.9% of labor force

This time:

5.1% of labor force



Source: WA State ESD, ERFC; data through May 2010

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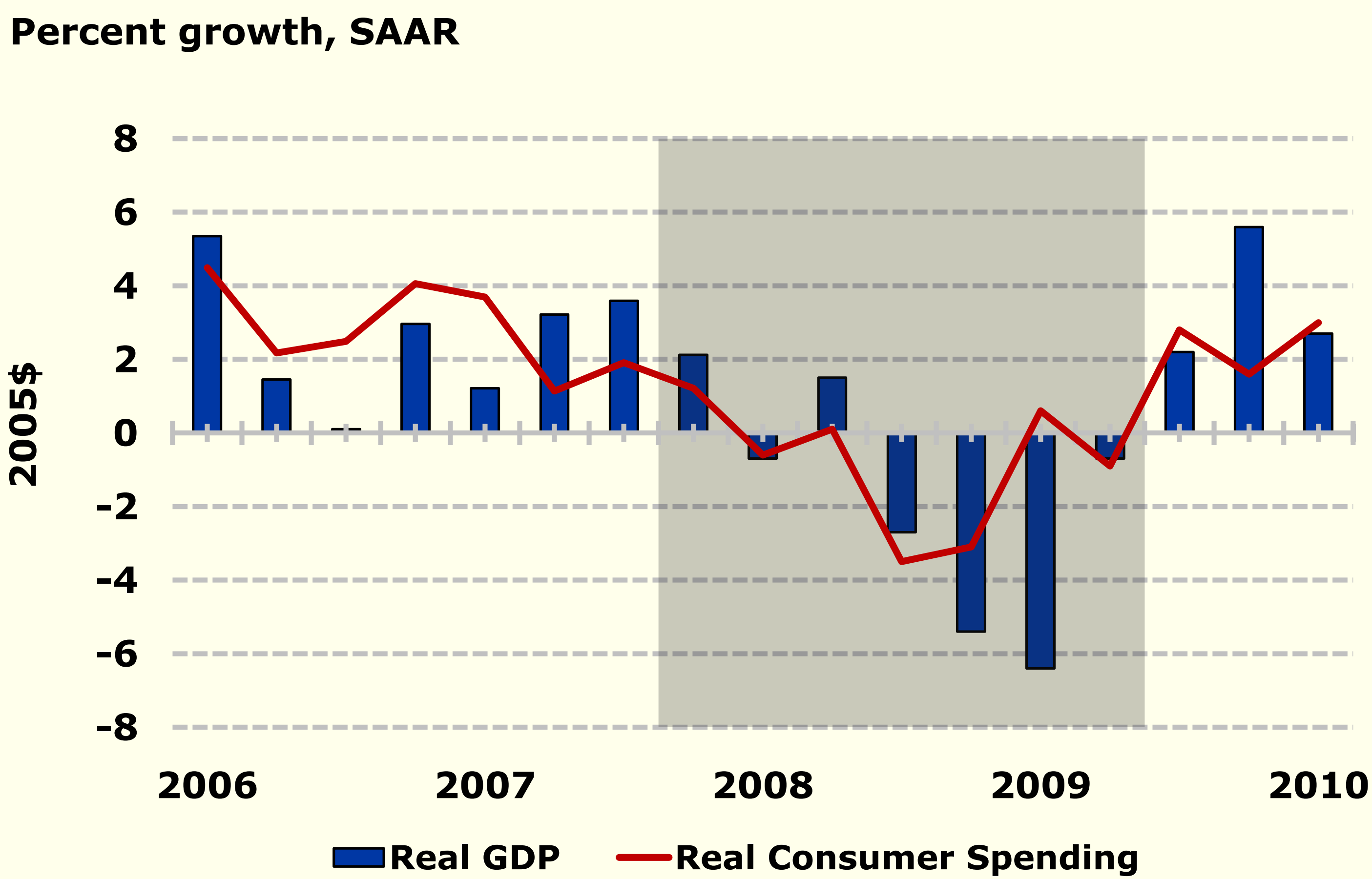
We have had 3 consecutive quarters of GDP and consumer spending growth



Source: BEA, data through 2010 Q1

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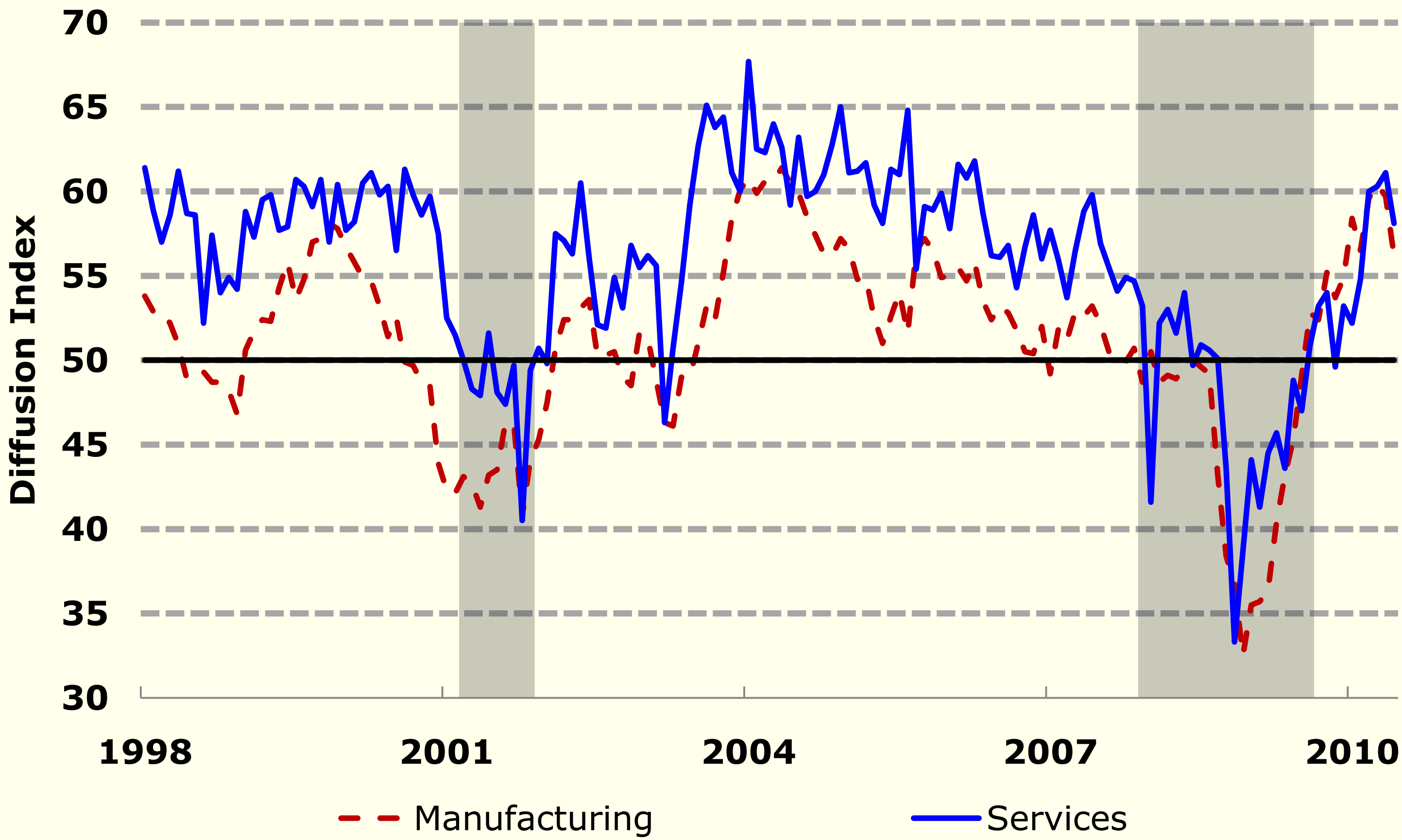
ISM indices for both services and manufacturing indicate growth

An index greater than 50, implies growth



Source: Institute of Supply Management; data through June 2010

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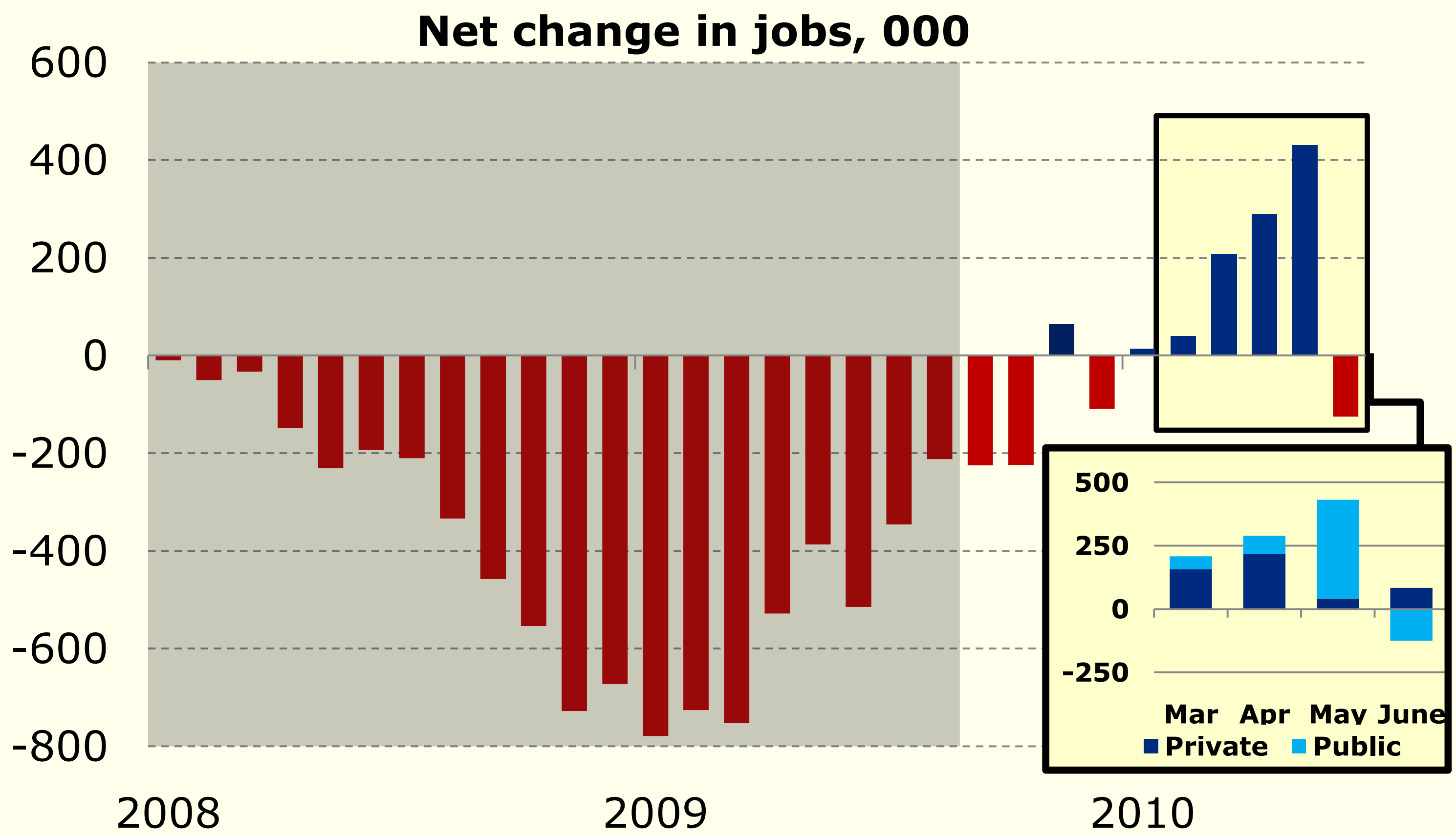
The jobs recovery stalled in May, and remains weak in June

Only 33,000 private sector jobs were added in May, down from 218,000 in April



Source: BLS; data through June 2010

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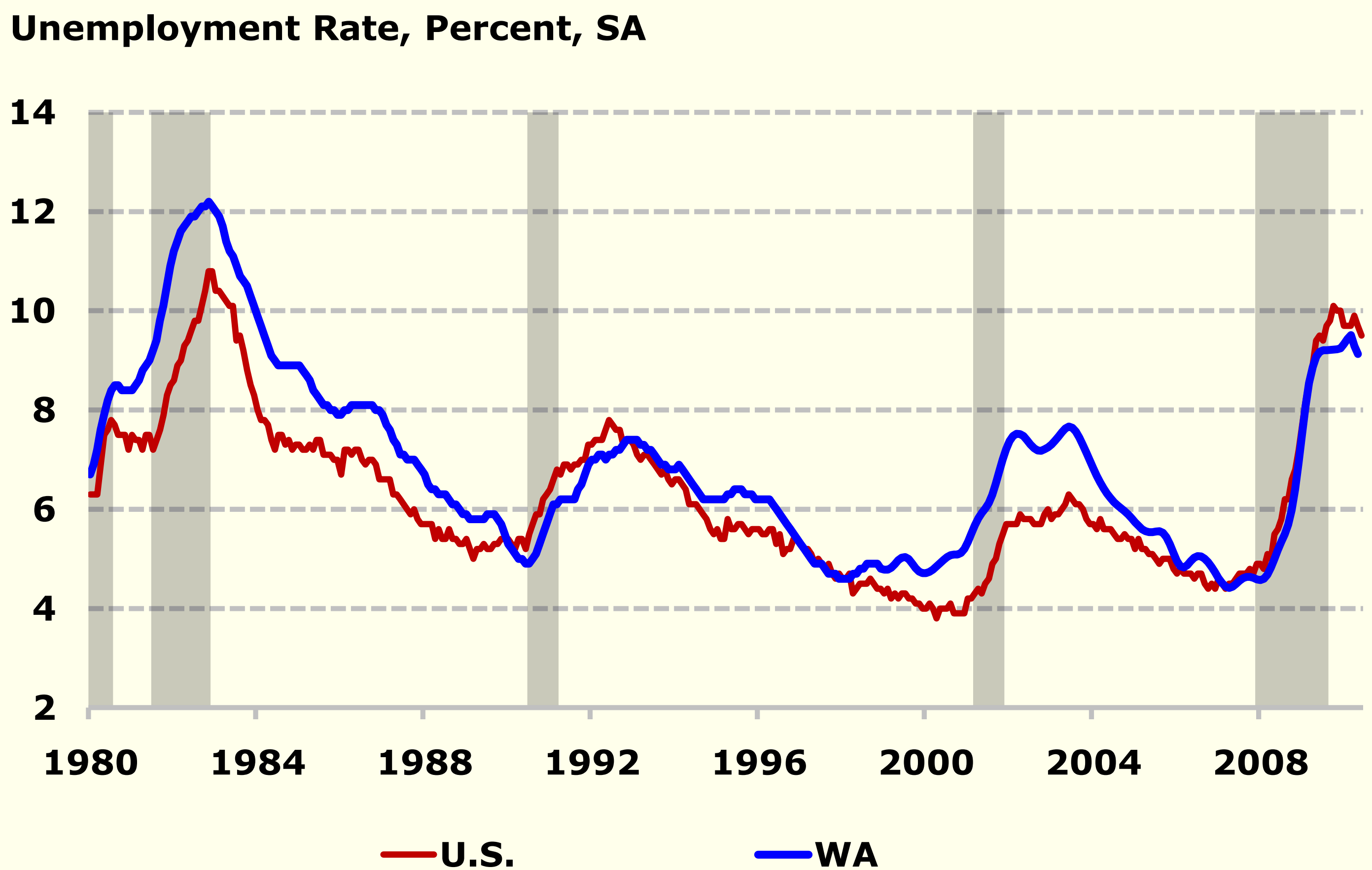
Unemployment is still high

It is normal for this rate to continue to rise even after the economy is in recovery



Source: WA ESD, BLS; data through June 2010

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The S&P 500 VIX volatility index has spiked recently

This index is a proxy for fear and uncertainty in markets

Source: Yahoo Finance; data through July 7, 2010

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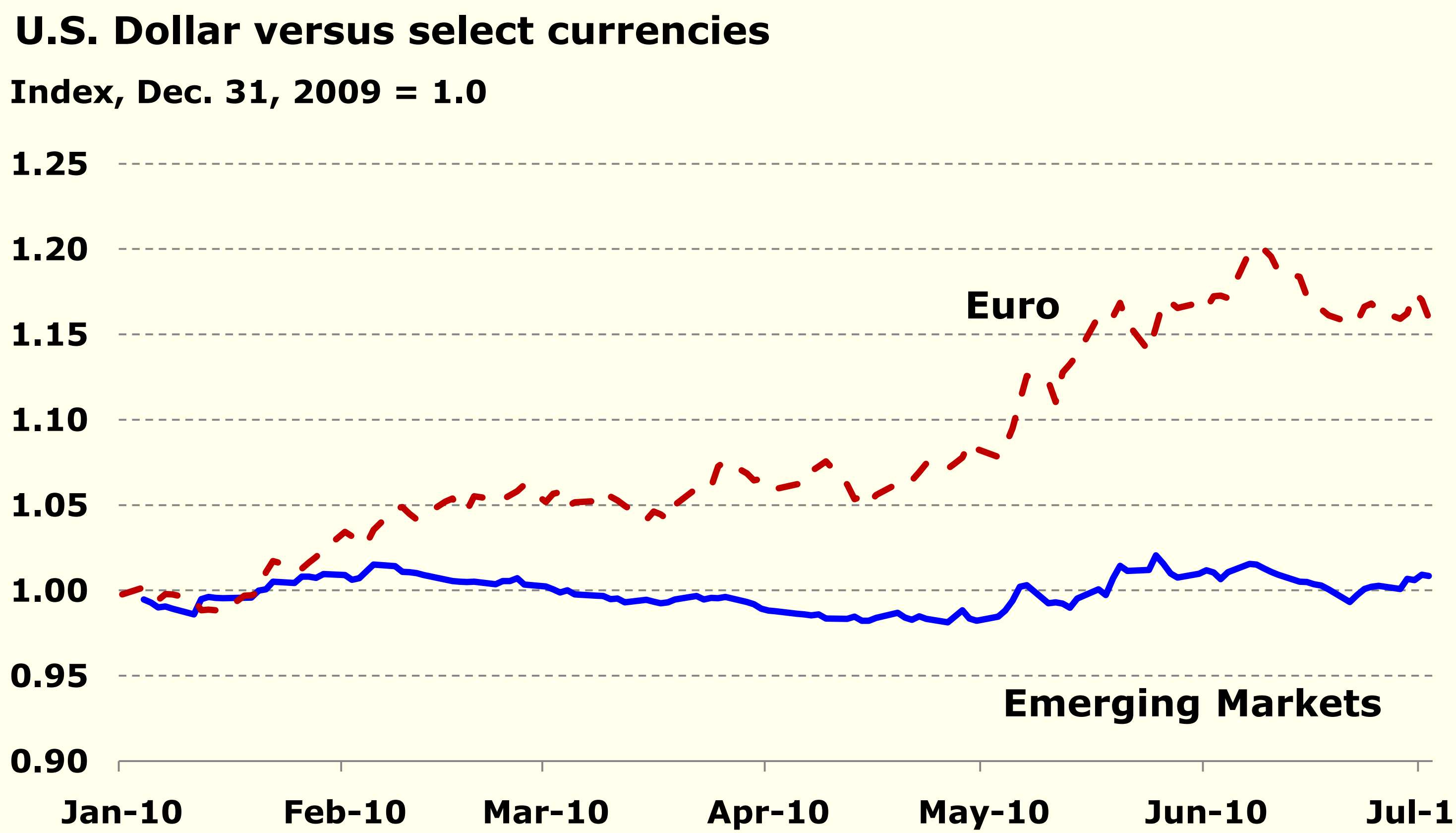
The USD has appreciated against the EUR this year, but not against emerging market currencies



Source: US Federal Reserve Bank, ERFC; data through July 2, 2010

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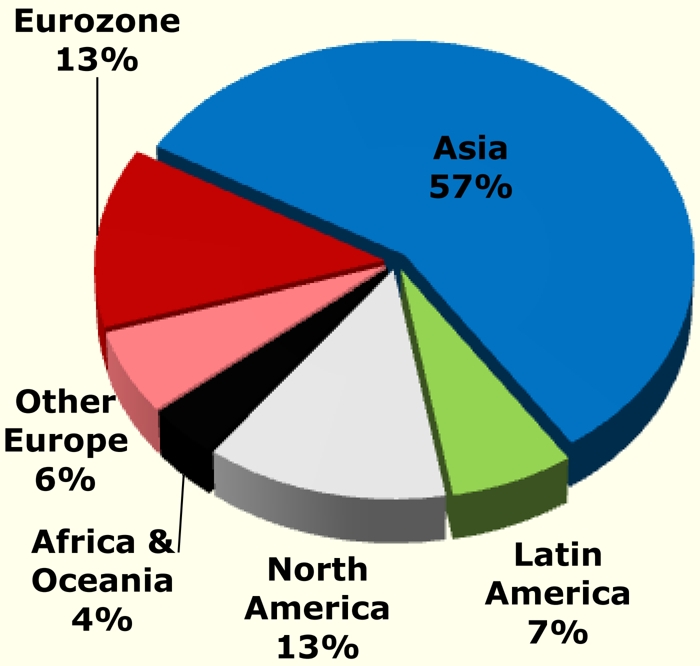
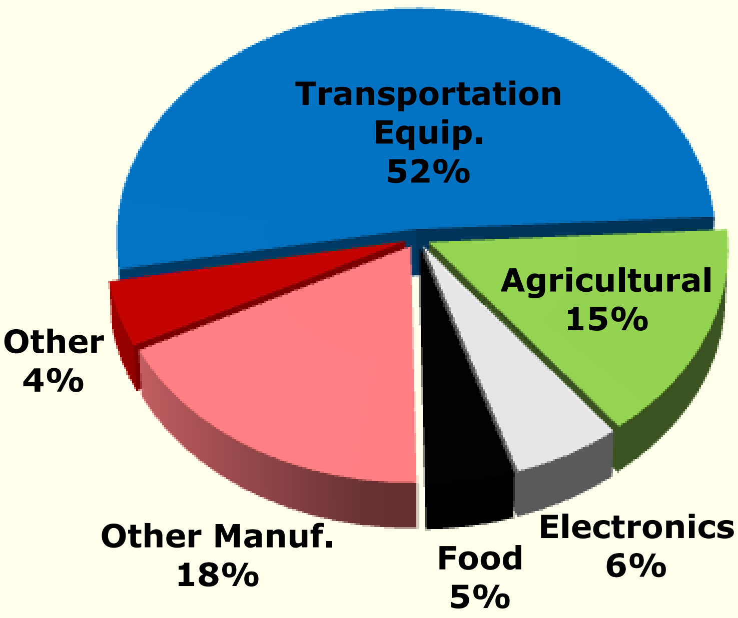
Washington exports much more to Asia than Europe

2009

By Region



By Industry



Source: Wiser Trade Data

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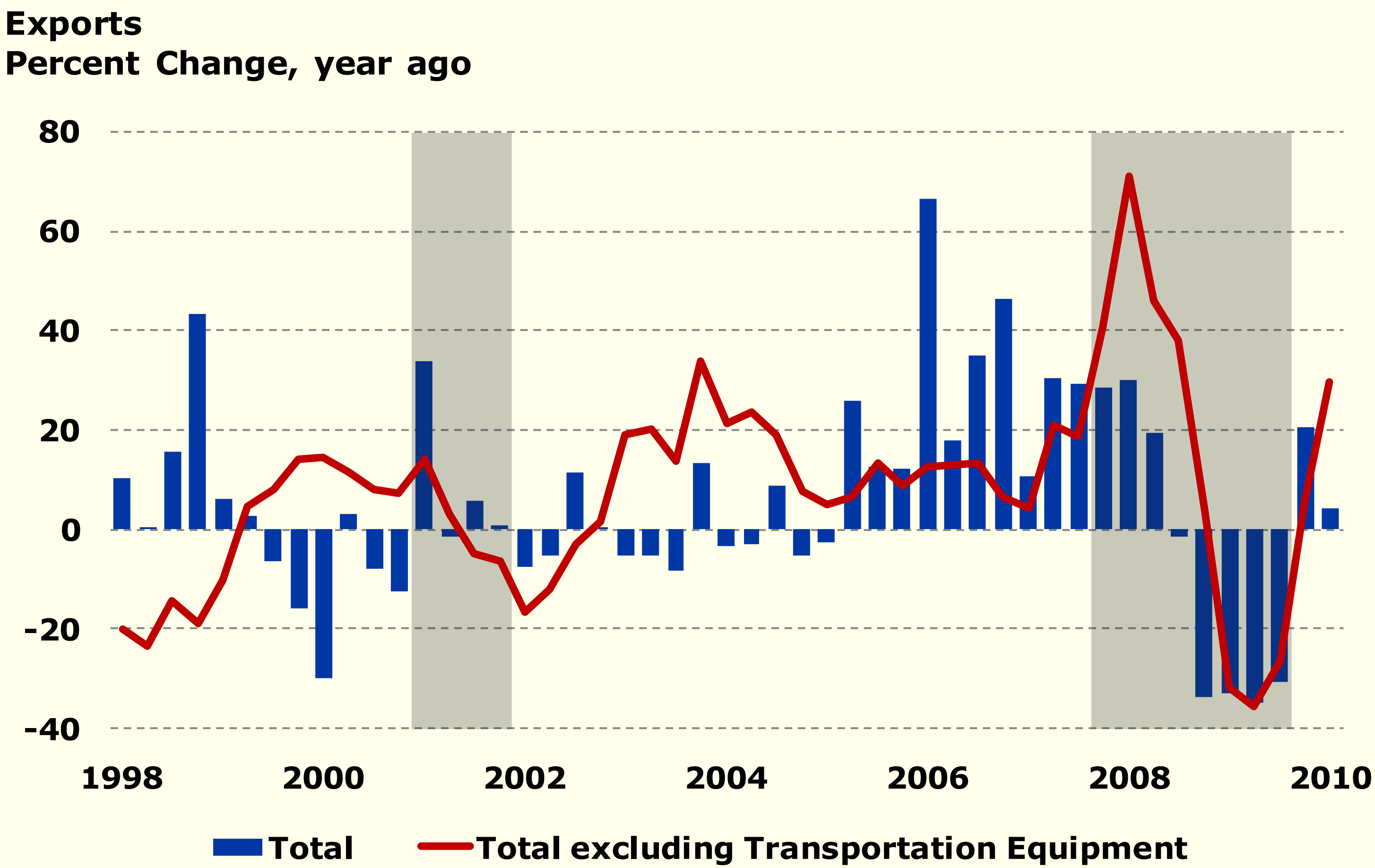
Exports will help the state recover faster than the nation

Exports excluding transport equipment were up 30% in Q1



Source: Wiser Trade Data; through 2010 Q1

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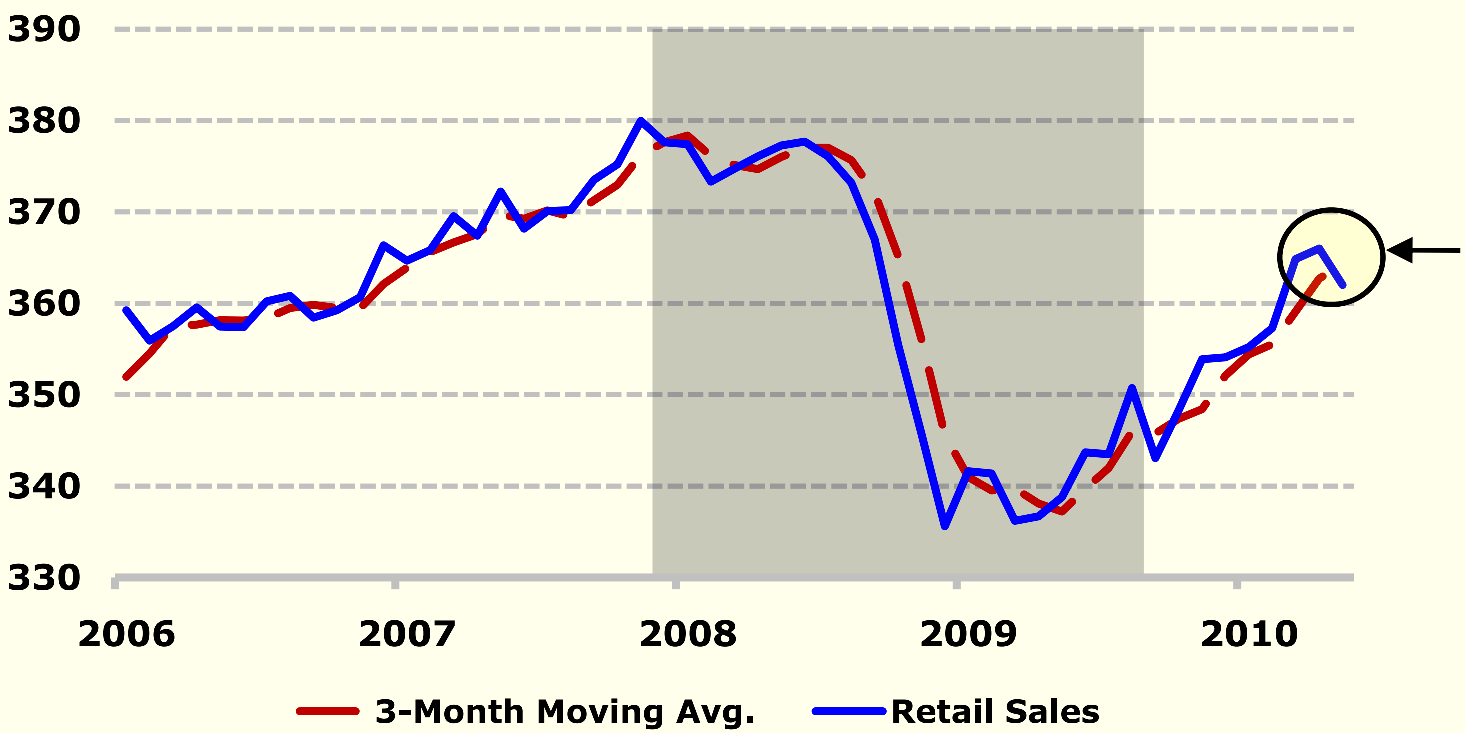
Retail sales fell in May and June

U.S. Retail Sales and Food Services
USD, billions



Source: U.S. Census Bureau; data through June 2010

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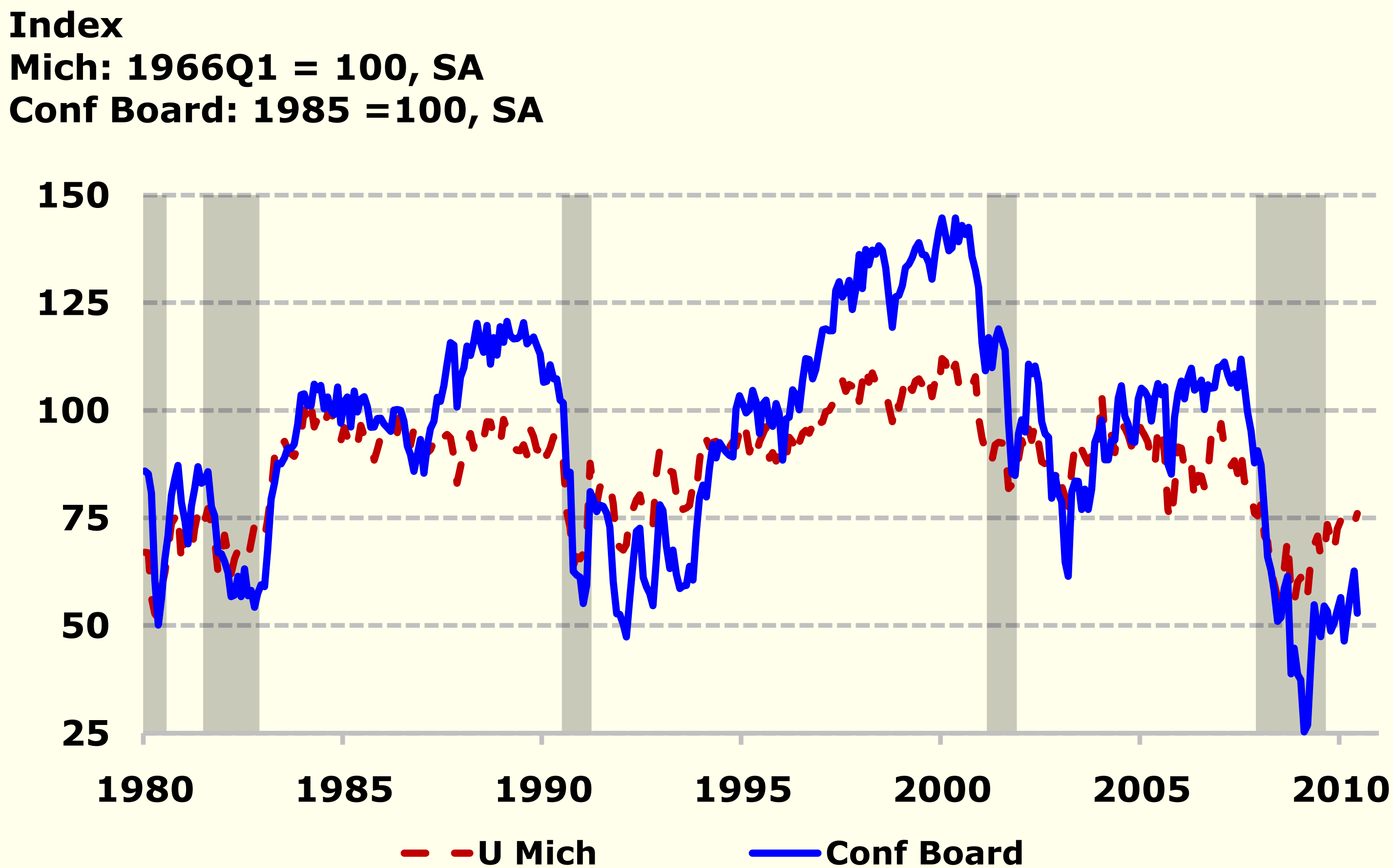
Consumer confidence is improving, but slowly



Source: University of Michigan; Conference Board, data through June 2010

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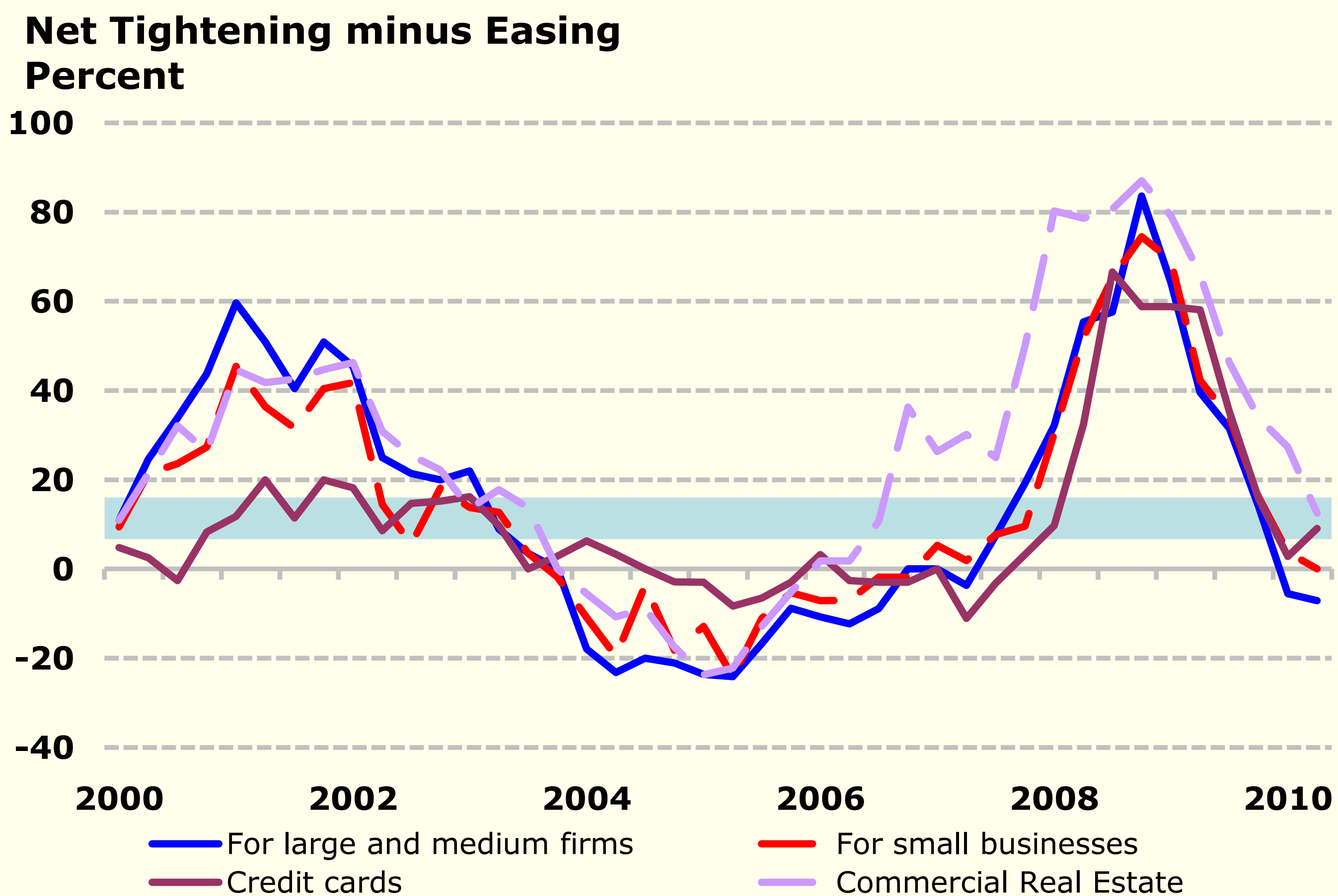
Large bank lending appears to be easing

Survey includes 60 large domestic banks and 24 U.S. branches of foreign banks



Source: Federal Reserve Board, Senior Loan Officers Quarterly Survey; data through April 2010 survey

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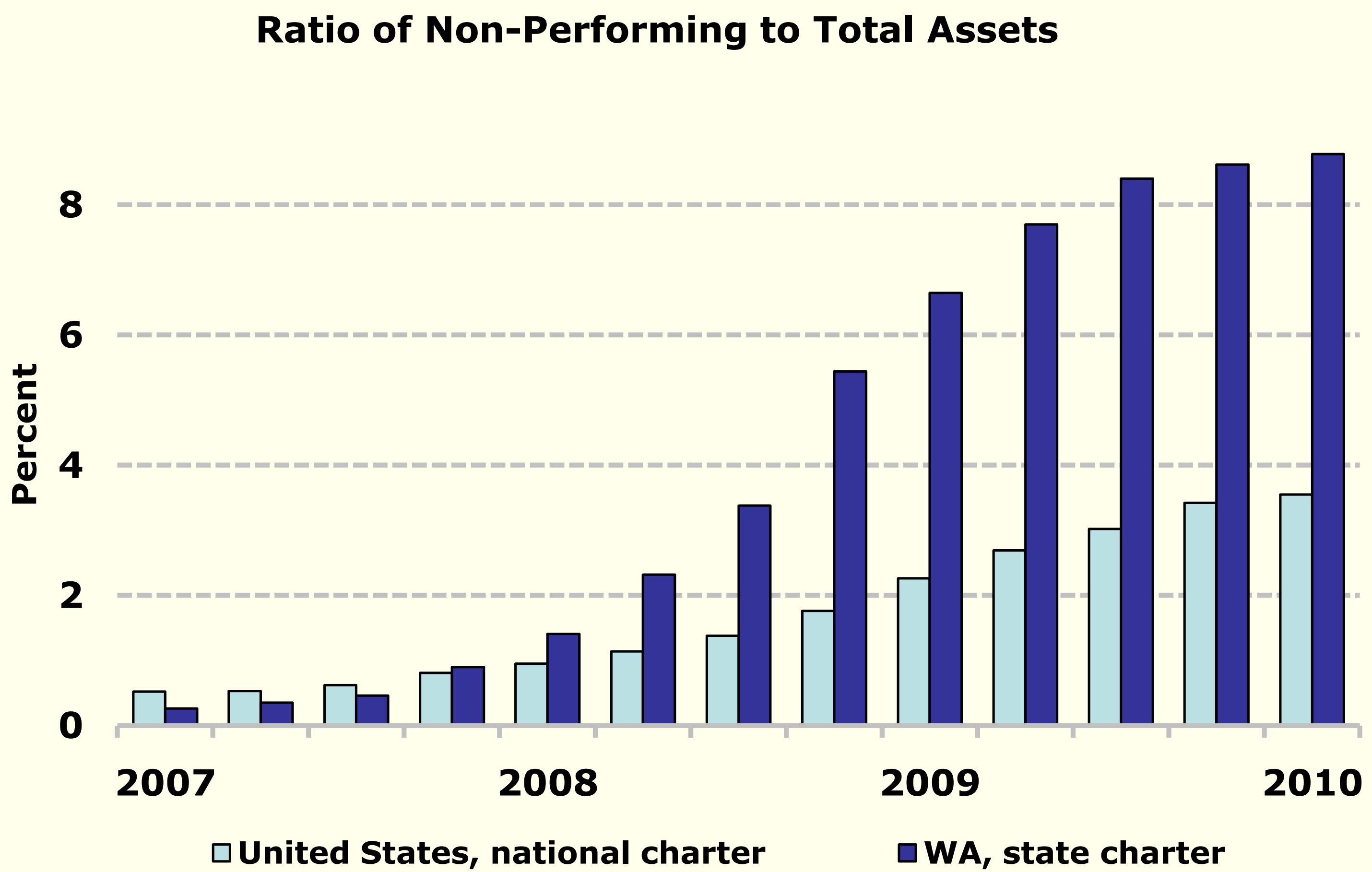
Asset quality of regional banks is poorer, but leveling off

The poorer asset quality of regional banks is due to their disproportion-ately high exposure to commercial real estate



Source: FDIC, data through 2010 Q1

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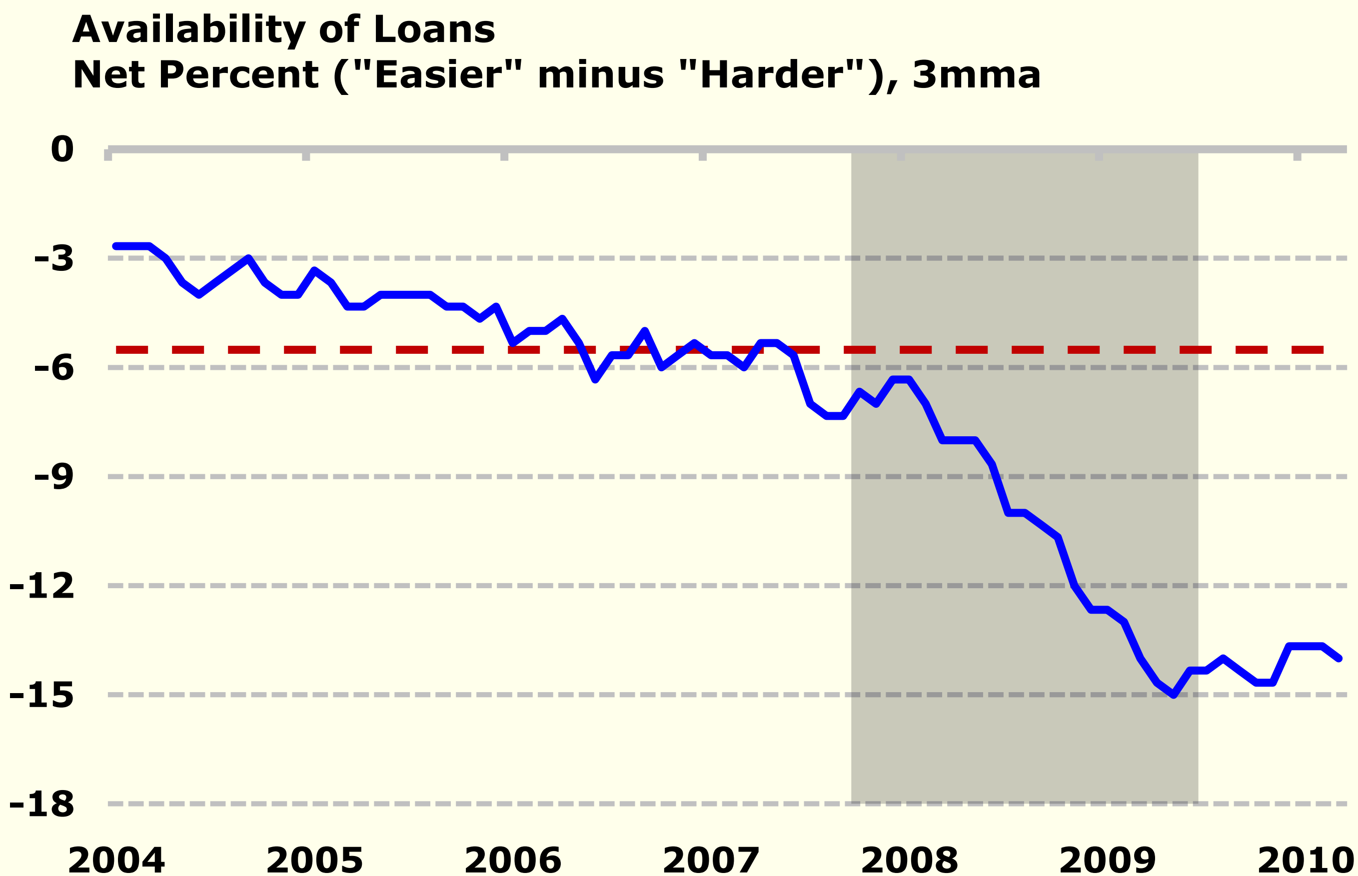
Credit conditions remain tight for small business



Source: National Federation of Independent Business; data through May 2010

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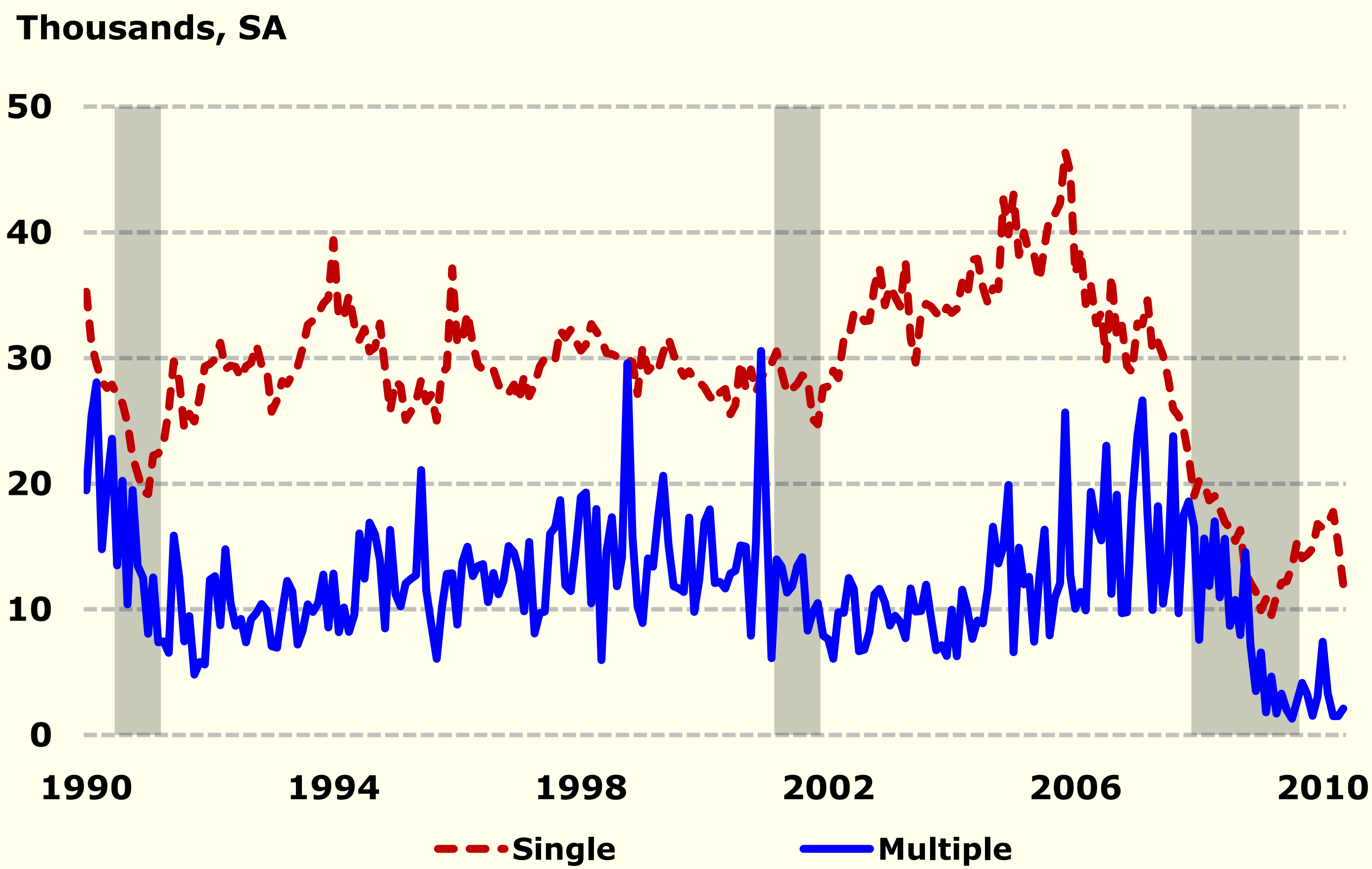
WA single family housing has collapsed, now that the first time homebuyer tax credit has expired



Source: U.S. Census Bureau; data through May 2010

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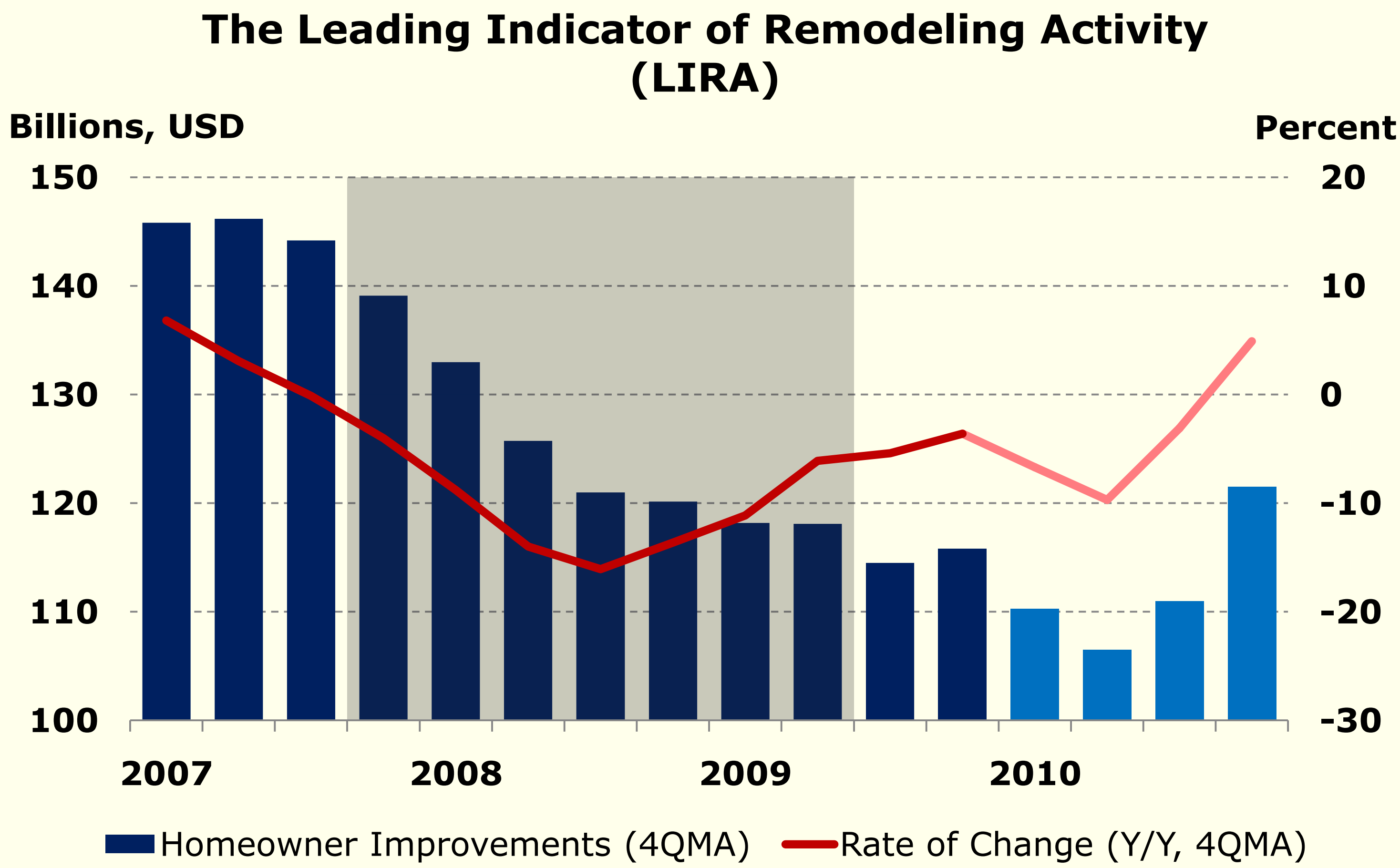
Leading indicator suggests remodeling improvement in 2010



Source: Joint Center for Housing Studies of Harvard University, actual data through 2009 Q4

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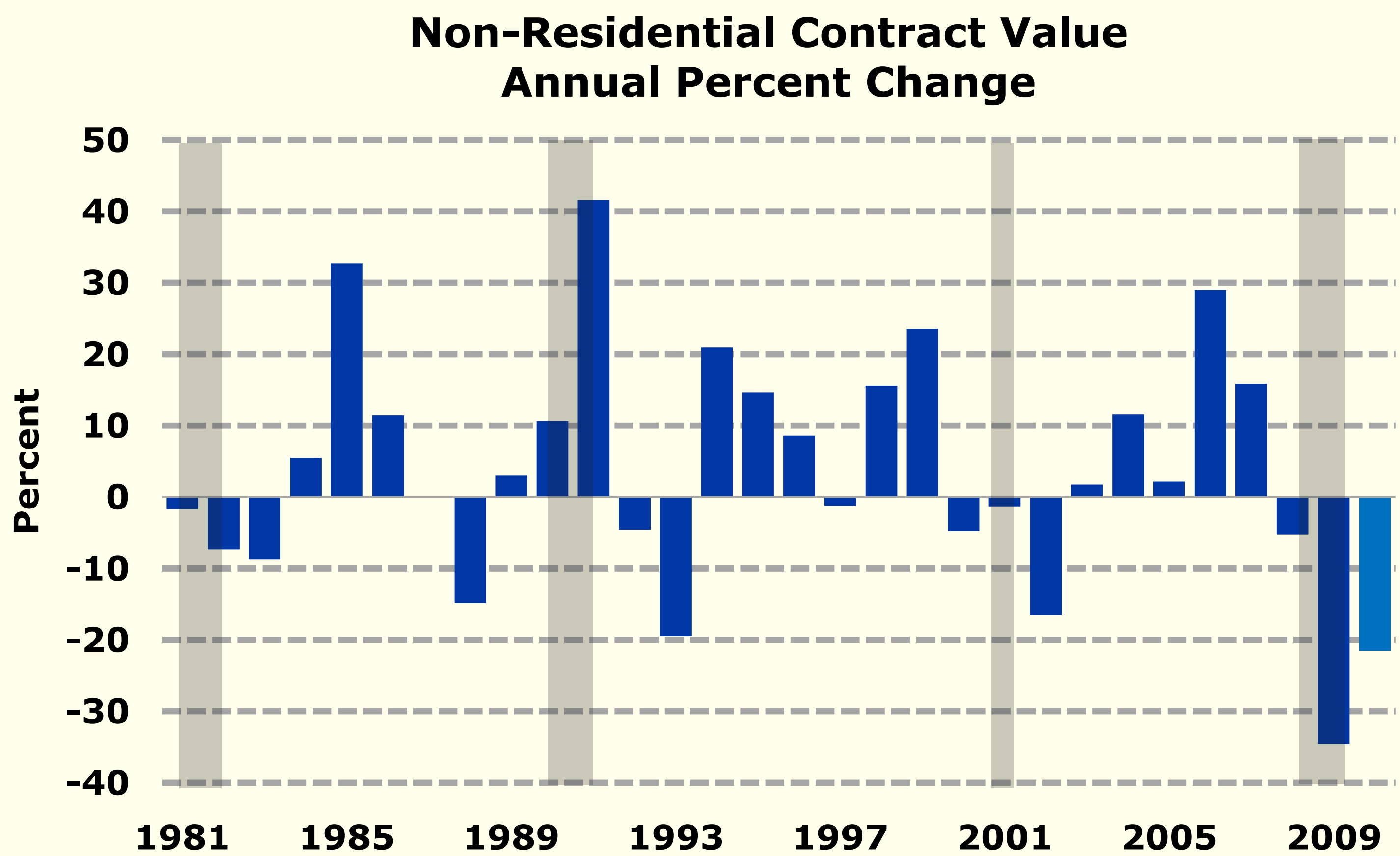
This is the worst downturn in non-residential construction in 30 years



Source: McGraw-Hill Construction, data through May, 2010

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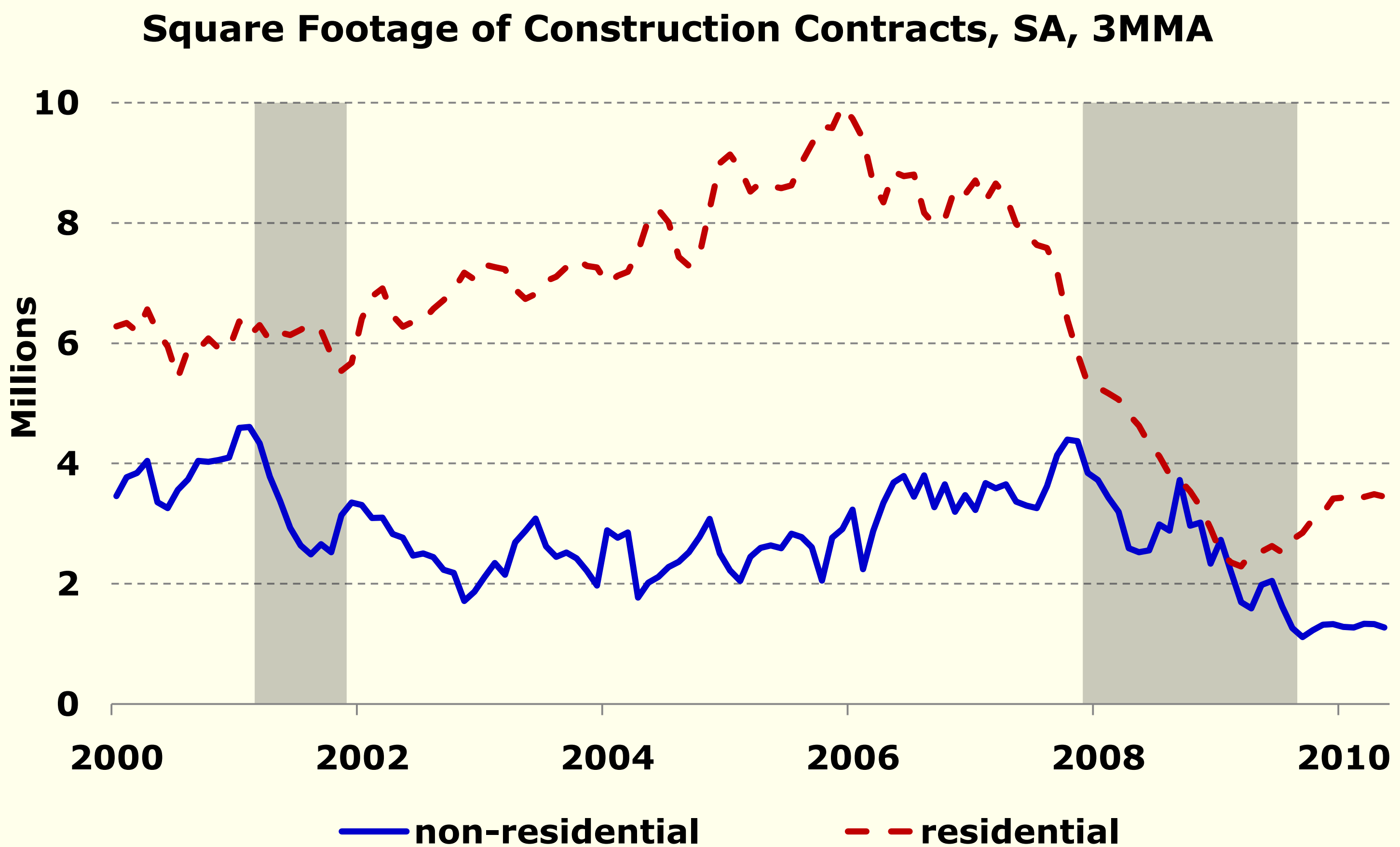
New construction in WA is no longer in free-fall, but the recovery will be weak

Residential square feet is up 55% since reaching a trough in Jan 2009



Source: McGraw Hill Construction, ERFC; data through May 2010

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Automotive sales continue to improve

National car sales were 19% higher in May 2010 than in May 2009

Cash for Clunkers effect removed

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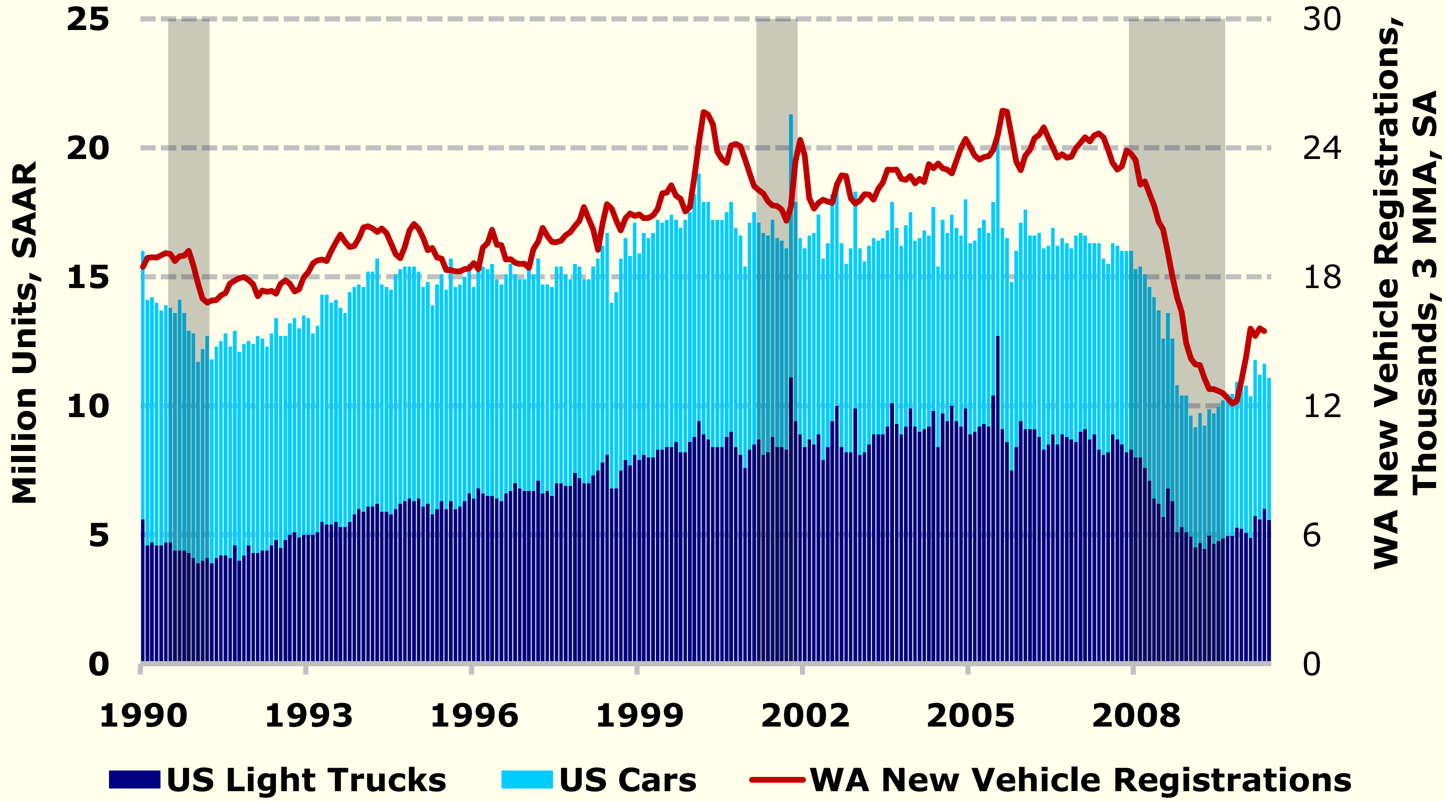
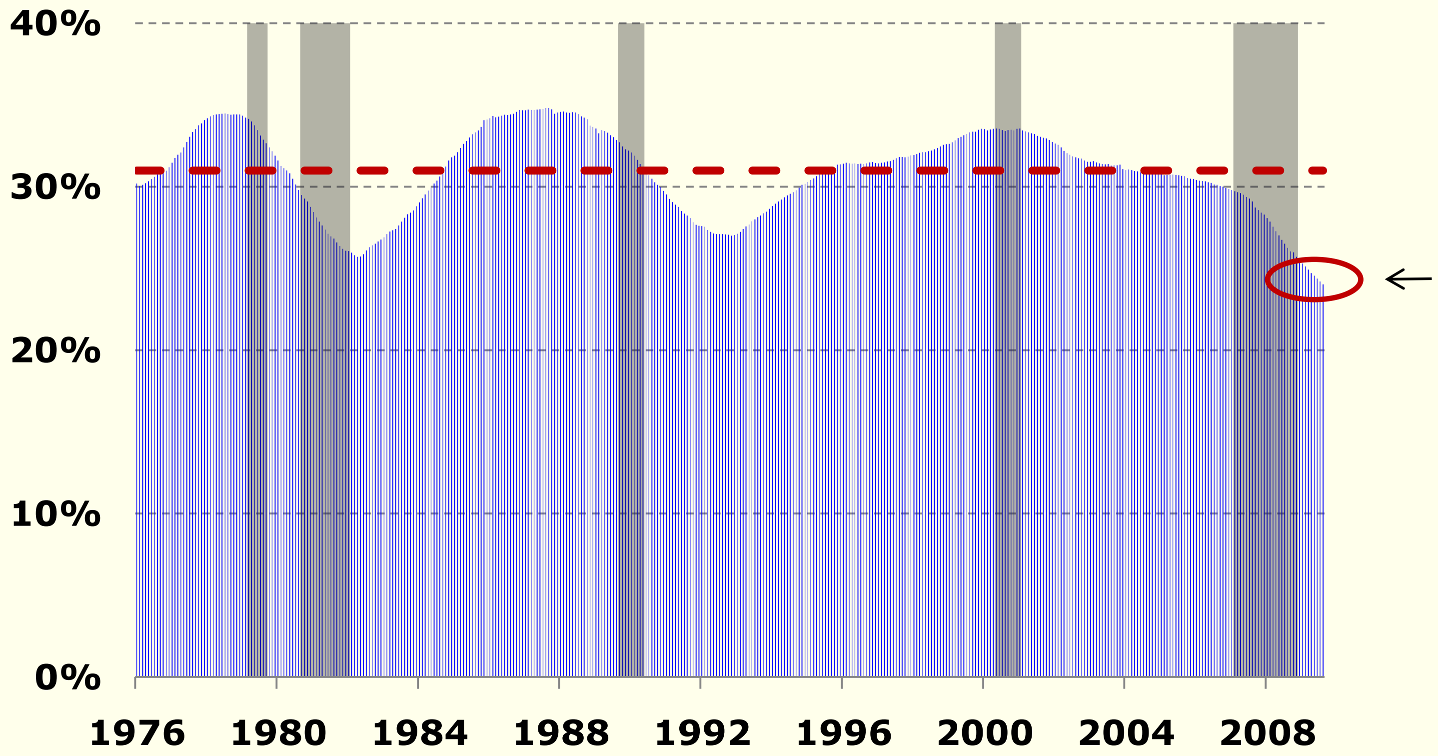


Source: Autodata Corporation, WA DOL; data through June 2010

Relative age of the car fleet indicates continued turnaround in car sales

The percent of "old" cars on the road is at a historic high



Source: Autodata Corporation, ERFC; data through June 2010

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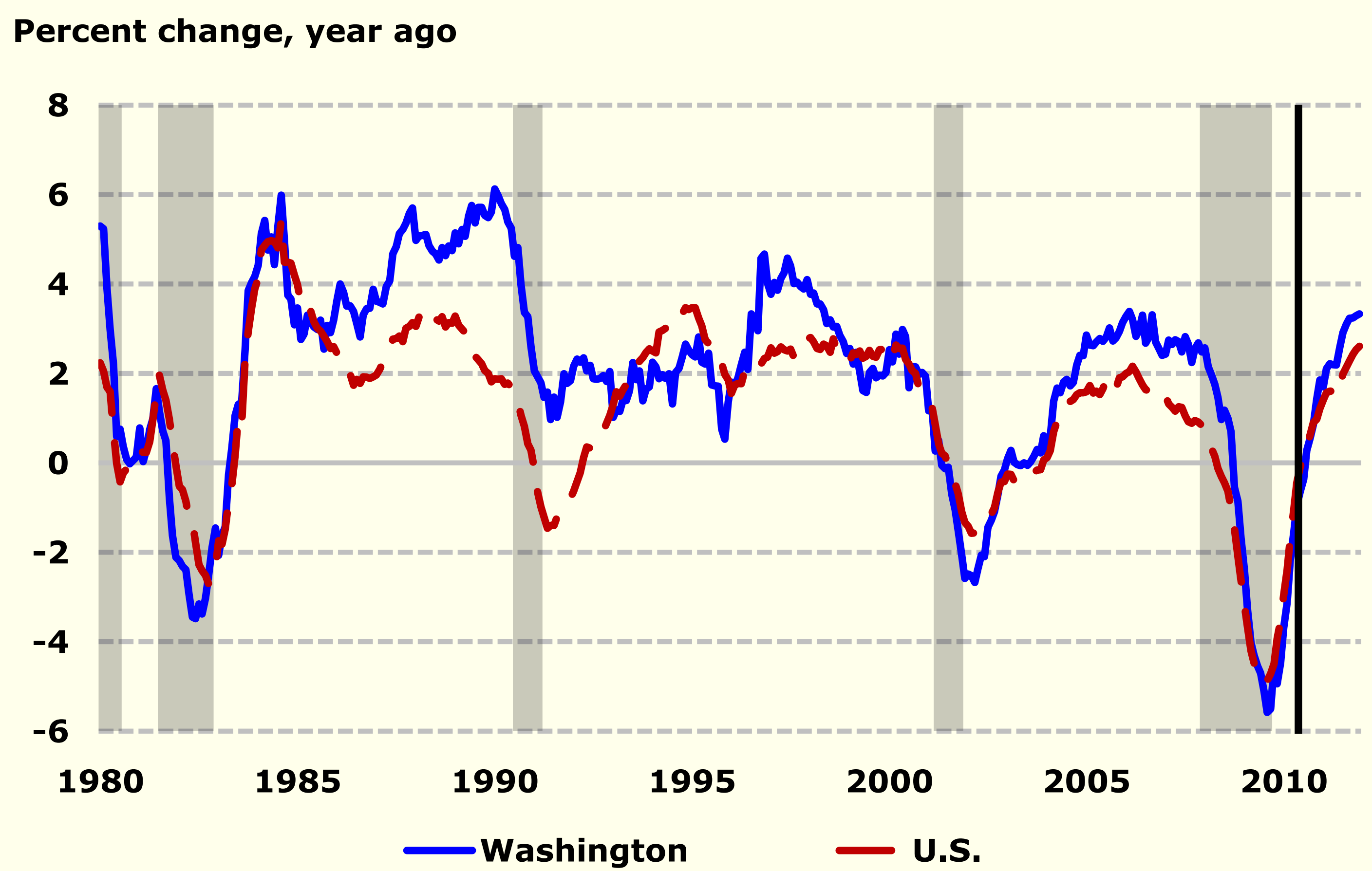
WA employment lagged the nation in the downturn and will recover stronger than the nation



Source: ERFC June 2010 forecast; actual through May 2010

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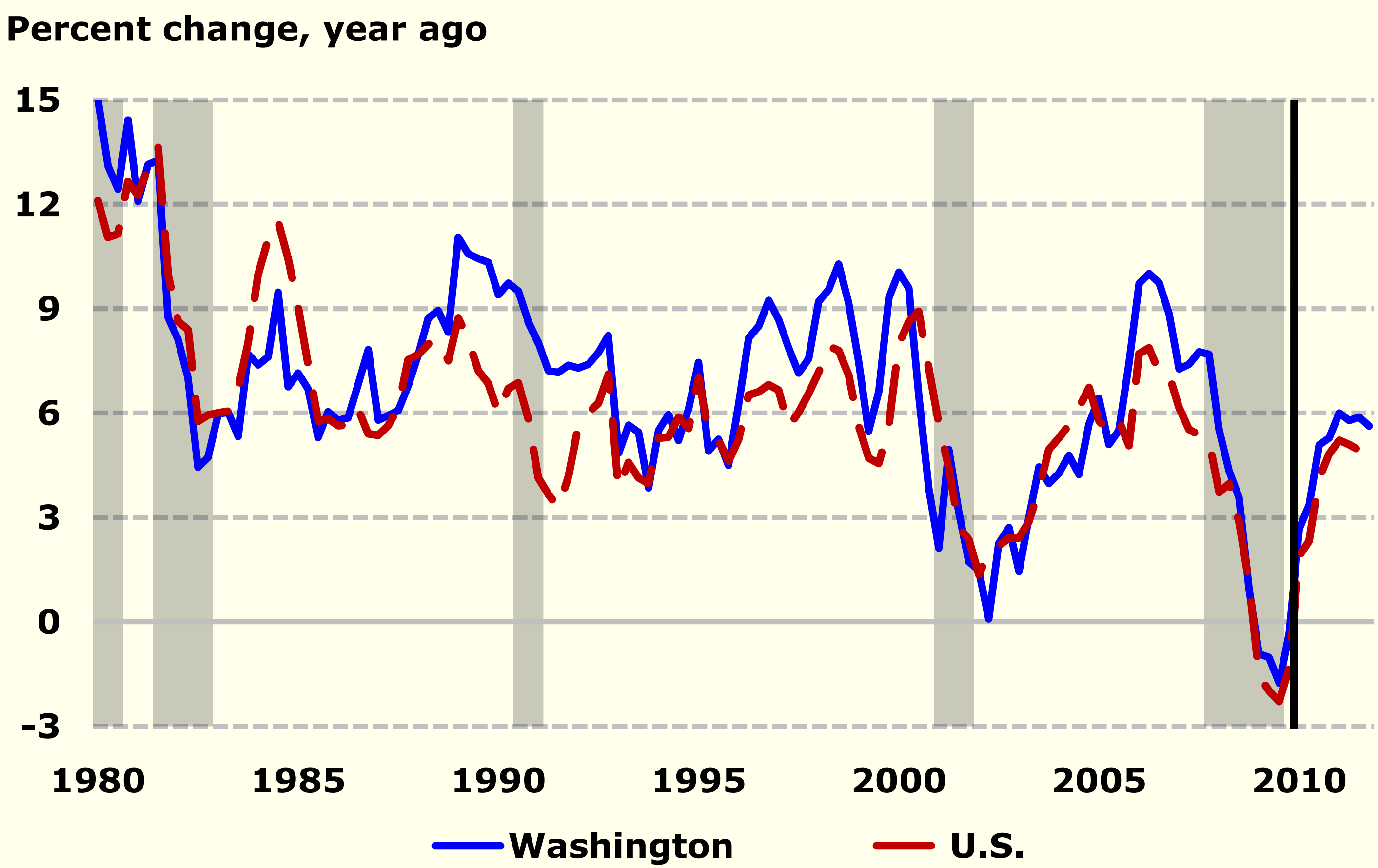
The recovery in WA personal income growth is expected to be better than the nation's



Source: ERFC June 2010 forecast; actual data through 2010Q1

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Forecast changes: General Fund State, 2009-2011 Biennium

February Forecast:

$28,725 million

USD millions		June '10 Forecast			
	Collection Experience	Non-economic Change	Forecast Change	Forecast	Total Change*
Dept. of Revenue	($34)	$749	($159)	$27,802	$556
All other agencies	($5)	$54	($47)	$1,481	$1
Total GF-S	**($39)**	**$803**	**($207)**	**$29,282**	**$558**

* Detail may not add to total due to rounding

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Forecast changes: General Fund State, 2011-2013 Biennium

USD Millions

USD millions		June '10 Forecast			
	February 2010 Forecast	Non-economic Change	Forecast Change	Forecast	Total Change*
Dept. of Revenue	$30,658	$1,556	$219	$32,433	$1,774
All other agencies	$1,566	$105	($21)	$1,650	$84
Total GF-S	**$32,225**	**$1,661**	**$197**	**$34,083**	**$1,858**

* Detail may not add to total due to rounding

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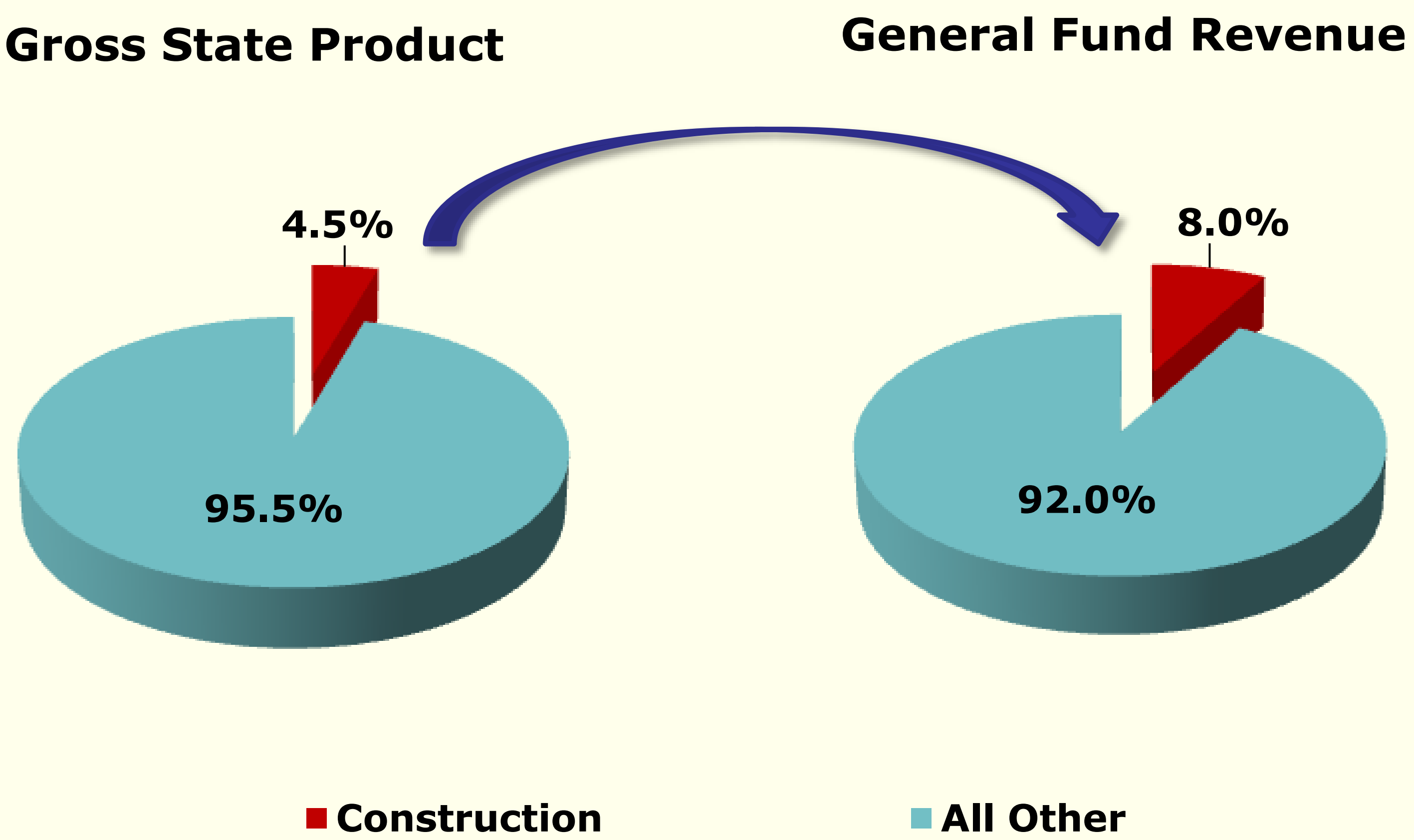
Construction contributes more to the GF-S than to State Product

1997 – 2004 Average

Excludes bubble years



Source: Bureau of Economic Analysis, ERFC

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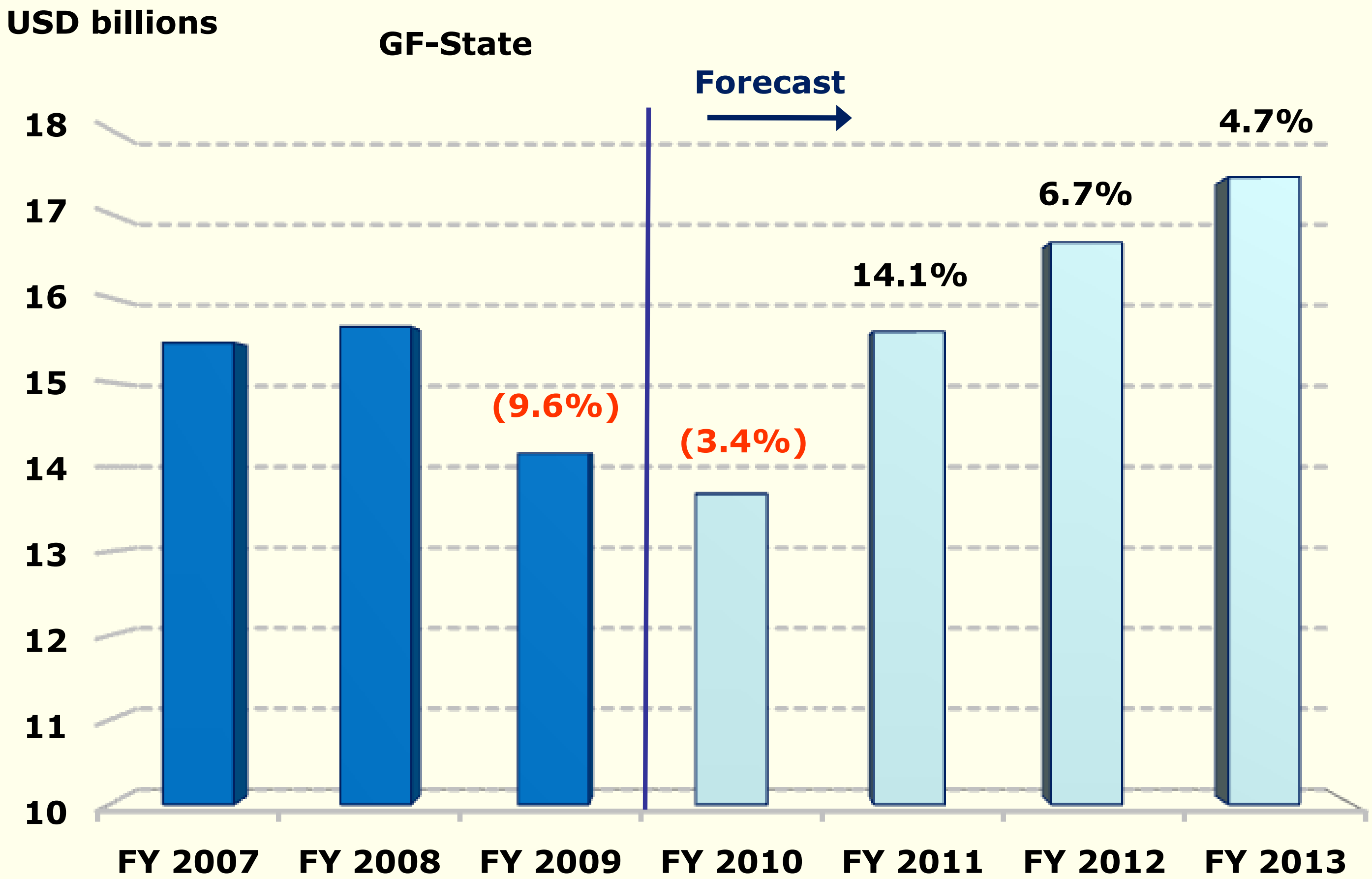
General Fund* forecast by fiscal year

* General Fund & Related Funds for FY 07, 08, and 09

General Fund – new definition, for FY 10-13



Source: ERFC forecast, June 2010; includes impact of legislative changes

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Conclusion

Pluses

- Recovery in progress
- Evidence of pent up demand
- Job growth has returned
- Car sales are improving
- Large banks able to extend credit

Minuses

- Weak May, neutral June
- Weak consumer confidence
- Credit still tight for small business
- Slow recovery in construction
- Possibility of European contagion

- Excluding non-economic factors the forecast shifts $200 million from this biennium to the next

Questions

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